Notes on the International Use of Student Loans

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A comparison of student loan programs in different countries can be aided by assuming two universal goals for such programs. These are:

1. ***To shift some portion of the costs of higher education that would otherwise be borne by government or taxpayers to the student;***

2. ***To increase higher educational access and participation;***

Let us briefly discuss some principles and "lessons learned" regarding each of these goals for student lending, informed by the examination of international experiences with student lending. [These "national experiences" include student loan programs in the US, Canada (both national and provincial), Sweden, Australia, China (new), the United Kingdom (new), Germany (the repayable portion of the BaföG), South Africa, and the host of experiments--and mainly failures--in other developing countries.]

The first goal of most loans programs is supporting "cost sharing," or "revenue supplementation": i.e. shifting some portion of the costs of higher education that would otherwise be borne by government or taxpayers to the student. Success in attaining this goal may be measured by the *effective cost recovery*: the present discounted value of the likely repayment streams. Enhancing this goal requires lessening the "losses and leakage" associated with excessive subsidization, excessive defaults, and excessive costs of servicing and collection. Policies to maximize, or at least to enhance, effective student loan cost recovery take three main forms:

First, charging an appropriate "real" interest rate applicable to the general borrower. That is, charging an interest rate at least near the market, or prime, rate or near the true value of money, which is probably near the cost of government borrowing *disregarding the cost of defaults or the cost of "purposeful subsidization."* In general, student loan programs should avoid excessive or unintended subsidization, or subsidization that serves mainly political ends, with little or no impact on student enrollment behavior.

Second, minimizing defaults. Lending to first-degree students—who are generally young and without established credit histories, especially in the absence of "risk rating" or requirements of guarantors or co-signatories—carries some unavoidable default risk. Defaults can be lessened by the following principles--*not all of which may be consistent with other goals of student lending*:

1. Observing realistic and responsible per-student limits on annual borrowing and aggregate indebtedness (e.g. taking into consideration prevailing starting salaries of current graduates of the particular academic program).

2. Following conventional "good lending," or "due diligence," practices (e.g. counseling at time both of borrowing and leaving the university or entering repayment, maintaining effective collection practices, and taking appropriate action against borrowers in arrears).

3. Attaching the student loan collection to the larger machinery and authority of government in its (a) tax or (b) pension or social security collections.

4. Lessening the burdensomeness of repayment by e.g.:

   a) providing sufficient repayment periods to allow realistic annual repayment burdens;

   b) providing income contingent repayment features to ease repayment burden for those earning minimal income;

   c) with conventional repayment plans, providing appropriate forbearance provisions for short-term hardships.

5. Limiting borrowing to those presenting the lowest likely risk of default: i.e. academically meritorious students within academic programs associated with high remuneration, such as law or business or computer engineering. [Note conflict with elements of the goal of maximizing accessibility or participation, below.]

Third, minimizing the costs of servicing and collection. The effective real cost recover (consistent with other objectives, such as those served by "purposeful subsidization," or by the avoidance of "risk rating" or the requirement of co-signatories) is further enhanced by minimizing the costs of servicing and collection through such practices as:

1. Utilizing existing offices and staff time of the university (e.g. a student support or financial assistance office) for the time and/or resources required for appropriate and responsible loan origination, in-school record keeping, and borrower "exit counseling."

2. Attaching the student loan collection to the larger machinery and authority of government in its (a) tax or (b) pension / social security collections.

3. If #2 is impossible, considering privatizing servicing and collections.

The second overall goal of most national student loan programs is to use student loans not merely to lessen government / taxpayer burden, but to increase higher educational access and participation. Student participation or accessibility can be enhanced through the availability of student loans in two ways. The first is by tapping parental willingness and ability to pay (i.e. "cost sharing"), which is made easier by having provision for assisting (not necessarily at taxpayer expense) those students whose parents still cannot or choose not to share in the costs of higher education. The second and more significant, but also more problematic, way is by allowing students to take on a significant portion of the higher educational cost burden in a way that can be repaid, thus recognizing the perceived private return to higher education) and releasing governmental, or taxpayer, funds either to expand the capacity or to support additional means-tested grants or loan subsidies. The following principles may help guide student loan programs to better serve as an engine of expanded higher educational capacity and accessibility:

1. Using "cost sharing" and the enhanced revenue from borrower repayments not to shift governmental or taxpayer revenues to other public needs, or to lower tax burdens, but to expand higher educational capacity and to enhance student financial assistance (including grants, loan subsidies and/or guarantees, and tuition "price discounts") to increase participation of those hitherto excluded either by lack of capacity or by the cost of higher education that must be borne by students or parents.

2. Assuring sufficient capacity for high-volume lending by tapping primary (private) capital markets and minimizing reliance on governmental appropriations as the source of lending. (This almost certainly requires governments to bear all or most of the risk of defaults, under the proposition that such a financial liability is not the proper responsibility of private capital markets, nor of the higher educational institutions themselves.)

3. Publicizing the appropriateness of student borrowing as a reasonable investment in one's own (or one's children's) higher education.

4. Supplementing the student loan program with appropriate means-tested student grants.

5. Linking student lending (and grants) to the university admission process.

6. Avoiding, or at least minimizing, "academic merit" as a criterion for loans or for loan subsidies.

7. Avoiding, or at least minimizing, requirements for individual guarantees (e.g. parental co-signatories).

8. In accord with # 6 and 7 above, making the government the principal or sole ultimate guarantor of student loans.

There will be additional analyses on international experiences with student lending through the International Comparative Higher Education Finance and Accessibility Project, a three-year, Ford Foundation-financed project under the direction of D. Bruce Johnstone at the University at Buffalo's Center for Comparative and Global Studies in Education. The Project will have a website at:

http://www.gse.buffalo.edu/org/IntHigherEdFinance

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